

Internal Revenue Service

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Person To Contact:

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PLR-113782-06

Date: July 18, 2006

Legend

X =

A =

B =

State =

CountryM =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Date7 =

Dear . :

This letter responds to your letter dated January 31, 2006, together with subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

The information submitted states that X was incorporated on Date1 under the laws of State, and elected to be an S corporation effective Date1. On Date1, A was the sole shareholder of X. On Date2, shares of X were issued to B, a resident alien employed by X. B entered into a shareholders agreement under which A had the right to purchase B's shares in the event that B's employment with X was terminated. The shareholders agreement provides that during the term of the agreement, no shareholder shall take any action or transfer any shares in any manner that would cause the revocation or termination of X's S election under § 1362. On Date3, B's employment with X was terminated. On Date4, A exercised the right under the shareholders agreement to buy B's shares with a proposed closing date of Date5. However, B failed to properly tender the stock to perfect a transfer. On or about Date6, B returned to CountryM. A filed a civil lawsuit against B to perfect the transfer of the shares as of Date5. On Date7, A and B entered into a settlement agreement that the transfer of the shares occurred on Date5.

X represents that the circumstances resulting in the potential termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Service.

LAW AND ANALYSIS

Section 1361(a) provides that the term "S corporation" means, for any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(d)(2)(A) provides that an election under § 1362(a) terminates whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d), (2) the Secretary determines that the circumstances resulting in the termination were inadvertent, (3) no later than a reasonable period of time after the discovery of the circumstances resulting in the termination, steps were taken so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period of inadvertent termination of the S corporation election, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the termination, the corporation is treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the information submitted and representations made, we conclude that X's S corporation election may have terminated because X may have had an ineligible shareholder. However, we conclude that, if X's S corporation election was terminated, such termination was inadvertent within the meaning of § 1362(f). Consequently, we rule that X will be treated as continuing to be an S corporation from Date6, and thereafter, provided that X's S corporation election was valid and was not otherwise terminated under § 1362(d). Additionally, from Date5 and thereafter, A will be treated as the owner of the shares of X stock previously held by B. If X and its shareholders fail to treat X as described above, this ruling shall be null and void.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express no opinion on whether X is otherwise eligible to be an S corporation.

This ruling is directed only to the taxpayer requesting it. Under § 6110(k)(3), it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being mailed to your authorized representative.

Sincerely,

Audrey W. Ellis
Senior Counsel, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purpose